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Before the

FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
Rate Regulation	)	

COMMENTS OF JOINT PARTIES ON THE THIRD NOTICE OF PROPOSED RULEMAKING

Paul Glist
Steven Horvitz
Christopher W. Savage
COLE, RAYWID & BRAVERMAN
1919 Pennsylvania Ave., N.W.
Suite 200
Washington, D.C. 20006
202-659-9750

Attorneys for Cable Operators and Associations
(Listed in Footnote 1)

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Introduction and Summary

The undersigned cable operators[1] submit these comments in response to the **Third Notice of Proposed Rulemaking** ("3d NPRM") issued in this matter on August 27, 1993.[2] The

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1 The parties joining in these comments are: KBLCOM, Inc., Century Communications Corp., Jones Intercable, Inc., TeleCable Corp., Bresnan Communications, Corp., Greater Media, Inc., Monmouth Cablevision, Assoc., Rifkin & Associates, Western Communications, Allens Television Cable Service, Inc., Brownwood Television Cable Service, Inc., CableSouth, Inc., Coosa Cable Company, Inc., Corsicana Cable TV, Inc., Halcyon Communications, Inc., Helicon Corp., James Cable Partners, Cablevision, Inc., Phoenix Leasing, Inc., Rock Associates, Satcom, Inc., Sjoberg's, Inc., Sweetwater Television Company, TCA Cable, Inc., United Video Cablevision, Inc., Zylstra Communications Corp., Cable Television Assn. of Georgia, South Carolina Cable Television Assn., Tennessee Cable Television, Assn., Texas Cable TV Assn.

2 **In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 -- Rate Regulation**, First Order on Reconsideration, Second Report and Order, and Third Notice of Proposed Rulemaking, MM Docket No. 92-266 (August 27, 1993). The Third Notice of Proposed Rulemaking comprises ¶¶ 132-154 of this document.

Commission must be careful in this proceeding to avoid decisions that risk strangling cable's continued development over the next few years.[3]

First, the Commission should allow cable operators to pass the costs of required system upgrades on to subscribers under the terms of the Commission's rules governing "external" costs.[4] Otherwise, local franchising authorities will have no incentive to limit required upgrades to those which subscribers actually need or want.

Second, the Commission should not force cable operators who have defended rates on one tier using a cost-of-service approach to rely on that same approach to defend rates on other tiers. Instead, the Commission should make clear that rates that are reasonable under the benchmark system need not be subjected to cost-of-service review.

Third, in connection with adding channels to existing systems, the Commission should adopt, as a three-year transition mechanism, the proposal contained in Paragraph 137 of the 3d NPRM -- i.e., allow system operators to add channels at their current

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[3] These joint comments and proposals are without prejudice to the arguments Century Communications Corp. has separately made in its Petition for Reconsideration at the Commission. For the reasons set forth therein, Century maintains that the Commission's attempt at benchmark regulation is unlawful under the Cable Act. In the event that the Commission's benchmark regulation is appropriate, these reply comments set forth Century's views as to the specific deficiencies in the Commission's current proposal, and how those deficiencies should be corrected.

[4] See 3d NPRM, ¶¶ 153-54.

per-channel per-subscriber rate. This mechanism would be consistent with the objective of retaining a system of benchmark regulation that is simple and streamlined, and would facilitate service upgrades during this otherwise chaotic transitional period.

Finally, the Commission should not defer to local franchising authorities' decisions on matters of ratemaking policy. Local authorities lack the Commission's national sphere of concern, as well as the Commission's experience in cost-of-service ratemaking.

1. THE COMMISSION SHOULD ALLOW AN "EXTERNAL COST" ADJUSTMENT TO BENCHMARK RATES TO REFLECT THE COST OF UPGRADES REQUIRED BY FRANCHISING AUTHORITIES.

Cable operators must be allowed to treat the costs of system upgrades required by local franchising authorities as "external costs" under the Commission's benchmark rules. Several factors support this conclusion.

First, there can be no question that system upgrades imposed on a cable operator by a franchising authority are beyond the operator's control. As a result, these costs are clearly "external" to the system operator's own business operations.[5]

Second, there is no basis to believe that upgrade costs that are unique to the requirements of a particular local franchising authority will be reflected in the GNP-PI. As a result, there is no need for concern that allowing external

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[5] System upgrades required under an existing franchise, but completed after the initial September 1992 rate survey, should also be afforded "external" treatment.

treatment of required upgrade costs would result in any "double counting."

Third, if system operators are **not** allowed to pass on costs of required upgrades, then local franchising authorities would have no incentive to avoid imposing unreasonable or uneconomic upgrade requirements. To the extent, however, that franchising authorities know that costs of required upgrades **will** be passed on, this should lead those authorities to consider whether subscribers will view the benefits of the particular upgrade under consideration to be worth its costs. This market-like incentive on local franchising authorities will further the Commission's overall objective of regulating cable rates in a way that mirrors the operation of a competitive market.

2. CABLE OPERATORS SHOULD BE ALLOWED TO RELY ON BENCHMARK RATES ON ONE TIER REGARDLESS OF WHETHER RATES ON ANOTHER TIER WERE JUSTIFIED USING COST-OF-SERVICE PRINCIPLES.

The Commission has held that its primary regulatory approach for cable will be the benchmark system.[6] Cost-of-service regulation, by contrast, is intended to be nothing but a regulatory "backstop" to protect system operators from unduly harsh results of applying the benchmark formula in particular

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[6] **See In the Matter of Implementing Sections of the Cable Television Consumer Protection and Competition Act of 1992 -- Rate Regulation**, Report and Order and Further Notice of Proposed Rulemaking, MM Docket No. 92-266 (May 3, 1993) ("Rate Order") at ¶ 262; **In the Matter of Implementing Sections of the Cable Television Consumer Protection and Competition Act of 1992 -- Rate Regulation**, Notice of Proposed Rulemaking, Docket No. 93-215 (July 16, 1993) ("Cost-of-Service NPRM") at ¶ 7.

cases.[7]

The Commission based this approach on its view that the benchmark approach fairly reflects the impact of competition from another cable system.[8] In reliance on this view, moreover, the Commission has required rate rollbacks totalling hundreds of millions of dollars.

Despite the Commission's reliance on the benchmark formula when the issue is justifying rate cuts, the Commission proposes severely restricting the ability of operators to use benchmark rates as a "safe harbor." Indeed, under the suggestion in the 3d NPRM, a cable operator's ability to rely on the benchmarks for any regulated tier would be contingent on the operator's willingness to forego the protections of a possible backstop cost-of-service showing on **all** regulated tiers.[9]

This proposal is arbitrary and unreasonable. If the Commission remains committed to the view that benchmark regulation leads to reasonable, market-like rates, then there is no basis for ever **requiring** that cable operators make cost-of-service showings. If, on the other hand, the Commission is uncertain about the reliability of the benchmark approach, then the validity of a number of Commission actions -- including the rate rollbacks ordered earlier this year -- is thrown into question.

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[7] Cost-of-Service NPRM at ¶ 7.

[8] **See** Rate Order at ¶¶ 1, 14 & n.29, 15, 187, 392.

[9] 3d NPRM at ¶¶ 148-50.

There is no realistic basis for the Commission's stated concern that allowing cost-of-service showings for one tier while relying on the benchmarks for another tier will lead to "gaming." If the Commission is concerned that cable operators might allocate an unfairly high proportion of costs to the "cost-of-service" tier, the solution is for the Commission to prescribe rules governing cost allocation, not to walk away from the entire foundation of its approach to cable rate regulation.

The Commission could also add a simple additional protection against "gaming," if it were to conclude that such a course is desirable. Specifically, if a system operator has defended rates on one tier using cost-of-service principles, the cost-of-service data submitted in connection with that showing would be available for review by the regulator (local or federal) before whom the system operator is proposing to rely on benchmarks. Those data would show, among other things, the specific tier-to-tier cost allocations the system operator proposed to the "cost-of-service" regulator, so that any "gaming" could be readily detected.[10]

Along the same line, the Commission should abandon "tier neutral" rates on a going-forward basis. Whatever rationale may have existed for establishing the initial benchmark rates on a "tier neutral" basis, maintaining that approach into

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[10] The final cost-of-service rates would also be provided. Obviously, it is the costs included in the final rates, not the operator's initial submission, that determines whether any costs have been **actually** misallocated among tiers.

the future makes little sense. As operators experience increased "external" costs tied to particular channels, logic dictates that the rates should change only for the service levels containing the affected channels.

3. THE COMMISSION SHOULD ALLOW CABLE OPERATORS TO ADD CHANNELS AT THEIR CURRENT PER-CHANNEL PER-SUBSCRIBER RATES DURING A REASONABLE TRANSITION PERIOD.

The Commission proposes to require cable operators to lower their per-channel per-subscriber rates (corrected for changes in actual programming costs) when channels are added under benchmark regulation. The basis for this proposal is that subscribers should receive the benefit of "economies of scale" included in the benchmark formula.

Whatever validity the Commission's proposal may have as a long-run approach to benchmark regulation, that proposal should not be implemented immediately. Instead, for an initial three-year transition period, cable operators should be allowed to add channels to their systems at their **current**, unadjusted per-channel per-subscriber rates. After the Commission and system operators gain experience with this simple approach and its impact on channel additions, the Commission can adopt a permanent mechanism to reflect channel additions under benchmark regulation.

There are two key advantages to this proposal. First, it would facilitate service enhancements at a time when regulatory uncertainty would otherwise operate to discourage or defer system upgrades. Second, it would be simpler than the

Commission's preferred approach, in that it does not require additional calculations. Wherever possible the Commission should avoid complicating the benchmark approach.

In any case, system operators should always retain the option of making a cost-of-service showing in connection with an addition of channels, particularly where the increase arises in the context of an expansion of channel capacity. Otherwise, the **only** significant channel additions that will occur are those where the existing benchmark rates turn out, by happenstance, to be sufficiently high to cover the costs of a system upgrade.

4. THE COMMISSION SHOULD NOT DEFER TO LOCAL REGULATORY AUTHORITIES ON ANY ISSUES OF RATEMAKING POLICY.

The Commission also asks for comments on how to coordinate cost-of-service showings conducted by local franchising authorities and by the Commission itself in connection with different regulated tiers of service for a single system.[11] As discussed below, the Commission should resolve this issue by making binding determinations on all significant ratemaking issues and affording no deference whatsoever to local franchising authorities' decisions.

First, under the Communications Act, the Commission has an obligation to promote the development of new technologies and services, including cable television technology.[12] As the Commission has acknowledged in the **Cost-of-Service** rulemaking

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11 **See** 3d NPRM at ¶ 152.

12 **See** 47 U.S.C. §§ 157, 521; 1992 Cable Act, § 2(b).

proceeding, ratemaking determinations that affect cable operators' financial situation will significantly affect their ability to improve their systems and their services by deploying new technologies.

Local franchising authorities, however, do not share the Commission's statutory obligations or nationwide sphere of responsibility. To the contrary, those authorities face strong parochial pressures to keep basic cable rates low with few, if any, countervailing policy concerns. As a result, the Commission cannot reasonably assume that local franchising authorities' decisions on matters of ratemaking policy will reflect the proper balance among the important factors that the Commission itself must consider, including subscribers' interest in reasonable rates, operators' interest in a reasonable level of earnings, and the nation's interest in the deployment of advanced cable television technology at a pace that is not distorted by short-sighted regulatory decisions.

Deference to local franchising authorities is also inappropriate due to their generally low level of experience with the complexities of cost-of-service regulation. This Commission has almost sixty years' experience with the intricacies of cost-of-service ratemaking; local franchising authorities have effectively none. There is, therefore, no rational basis upon which the Commission could base a conclusion that local franchising authorities' views on ratemaking policy are entitled to any deference at all.

Finally, the structure of regulation established by the

Cable Act itself precludes undue deference to local franchising authorities. Under the Act, the Commission has exclusive authority to regulate rates for satellite tier services.[13] This means that the Commission itself must make its own determination of the reasonableness of satellite tier rates. The Commission could not fulfill its obligation to regulate those rates in the public interest were it to "defer" to local franchising authorities on any significant cost-of-service ratemaking issues.

For these reasons, the Commission should make as many binding determinations of ratemaking policy as it reasonably can before local franchising authorities actually render any decisions under cost-of-service principles. Also, when local decisions are before the Commission on appeal, the Commission should exercise its own, independent judgement regarding the appropriate ratemaking methodology to apply.

Conclusion

For the reasons stated above, the Commission should (a) allow cable operators to treat the costs of system upgrades required by franchising authorities as "external costs" to be recovered from subscribers; (b) permit cable operators to justify rates on any regulated tier using either the cost-of-service or benchmark methodology without regard to the methodologies used on other regulated tiers and without maintaining tier neutrality;

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[13] 47 U.S.C. § 543(c).

(c) during a three-year transition period, allow cable operators to add channels to existing systems at current per-channel per-subscriber rates; and (d) make binding determinations on issues of ratemaking policy for all regulated tiers, with no deference to decisions by local franchising authorities.

Respectfully submitted,

By: _____

Paul Glist
Steven Horvitz
Christopher W. Savage
COLE, RAYWID & BRAVERMAN
1919 Pennsylvania Ave., N.W.
Suite 200
Washington, D.C. 20006
(202) 650-9750

Attorneys for the following Cable Operators and Associations:

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